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No. 85-1744

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

WARREN ESSNER,

Petitioner,

—v.—

SECURITIES and EXCHANGE COMMISSION,

Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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June 2, 1986

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PRELIMINARY STATEMENT

Petitioner Warren Essner respectfully submits this Reply Brief in support of his Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit filed April 21, 1986, and in reply to the Brief in Opposition of the Securities and Exchange Commission (the "Commission") filed May 1986.[1]

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1 References to the Petition are cited "(Pet. at ____)." References to the appendix to the Petition are cited "(A ____)." References to the Commission's Brief in Opposition are cited "(Opp. at ____)."

REPLY ARGUMENT

This petition raises a single question of federal jurisdiction under the antifraud provisions of the federal securities laws: —Does federal jurisdiction exist when there is (a) an alleged misrepresentation, and (b) a securities transaction, regardless of whether the misrepresentation relates to the intrinsic value of the securities or "pertains" to the securities themselves in any other material way.

In our Petition we said resolution of this issue required a final determination of the conflict which exists between Justice Douglas' wide-reaching opinion in *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971), and both this Court's footnote to its opinion in *Rubin v. United States*, 449 U.S. 424, 429 n.6 (1981), and the opinion of Judge Friendly in *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930 (2d Cir.), *cert. denied*, 469 U.S. 884 (1984). We said (Pet. at 18):

> If, as in *Superintendent*, federal jurisdiction exists given (a) a fraudulent scheme which (b) happens to involve securities, then this Court should say so. If, however, federal jurisdiction exists only where the alleged fraudulent misrepresentations relate to the intrinsic value of the securities, or at the very least, pertain in a direct, material, and easily identifiable way to those securities themselves, this Court should say so. The inconsistency and chaos which has characterized this important area of federal law since 1971 must be eliminated. A clear definition of federal jurisdiction in matters involving securities must be established.

The Commission purports to resolve the issue without this Court's assistance by simply denying a conflict exists. It argues that *Superintendent* remains the controlling law, that *Rubin's* implicit limitation of *Superintendent* should be ignored as

irrelevant, and that Judge Friendly's decision in *Chemical Bank* is inapposite. The Commission's blithe treatment of a question which impacts *its* jurisdiction only underscores the need for certiorari in this case.

Rubin involved misrepresentations both of the value of securities pledged to secure a bank loan and of the financial condition of the borrower. This Court held a pledge of worthless stock violated the federal securities laws, but specifically refused to decide whether the borrower's false statement of financial condition—which actually induced the underlying loan transaction—was itself sufficient to establish federal jurisdiction. In a quite precise footnote this Court said:

> The misrepresentations at issue in this case related to the stocks themselves; petitioner does not allege that his conviction, insofar as it involved securities fraud under § 17(a), was based on misrepresentations made about the financial condition of Tri-State itself. Thus, we need not decide whether misrepresentations or omissions involved in a securities transaction but not pertaining to the securities themselves can form the basis of a violation of § 17(a).

449 U.S. at 429 n.6.

The Commission says this footnote "plainly was not meant to cast doubt on the Court's holding in *Superintendent of Insurance*" (Opp. at 9). But, if this is so, and if the footnote in *Rubin* "was not meant to cast doubt" on the reach of *Superintendent*, then, as even the Commission must concede, the *Rubin* footnote has no meaning at all. If that *is* the case, which seems most improbable, it is for this Court, and not for the Commission, to say so.

The Commission, undoubtedly insecure with a position which would leave the *Rubin* footnote without meaning, goes on to presume the *Rubin* footnote was only "intended to make it clear" that federal jurisdiction does not "extend . . . to every fraud which might occur in the course of conventional

bank loans" (Opp. at 9-10). Clearly, if that is what this Court meant in *Rubin*, it would have said so. But, the language of the footnote is not limited to "conventional bank loans," pledge transactions, or any other particular type of transaction which happens to involve securities. With obvious care, the footnote quite clearly leaves undecided the question of "whether misrepresentations or omissions involved in a securities transaction but not pertaining to the securities themselves" can form the basis for federal jurisdiction under the federal securities laws.

Chemical Bank also involved a bank loan secured by common stock. But, unlike *Rubin*, no misrepresentations were made with regard to the value of the collateral and plaintiff's theory of liability was based entirely upon an allegedly false statement of the guarantor's financial condition. *Chemical Bank* therefore presented a fact pattern which required judicial determination of the very issue left undecided in the *Rubin* footnote. Judge Friendly concluded that while the financial statement may have induced a securities transaction, namely, a bank loan collateralized by common stock, the alleged misrepresentations did not pertain to the pledged stock, 726 F.2d at 943 n.22, and therefore were not actionable under the federal securities laws.

Petitioner's case is before the Court on the same basic set of facts as *Rubin* and *Chemical Bank*. Petitioner is charged with issuing a false statement of financial condition which induced secured loan transactions; however, it is conceded that DGSI's financial condition had no bearing on the genuine U.S. government bonds which were the subject of those transactions. In order to avoid Judge Friendly's holding in *Chemical Bank*, the Second Circuit was forced to distinguish DGSI's repurchase agreements from traditional secured loan transactions (A7-A8), and then held that the alleged misrepresentation of financial condition in this case was sufficient to establish federal jurisdiction because it purportedly affected the *consid-*

eration for DGSI's repurchase agreements (A10).[2] It therefore never answered the question raised in *Rubin*, namely, whether the alleged misrepresentation "pertained to" the *securities themselves*. The decision below therefore said nothing more than federal jurisdiction exists whenever there is a misrepresentation in a transaction which happens to involve securities. In short, the Court below applied *Superintendent* without regard to *Rubin*.

We end where we started. If, as indicated in *Superintendent*, the misrepresentation in a transaction which involves securities is sufficient to invoke federal jurisdiction, as the Commission contends and the court below held, then this Court should say so. However, if, as indicated in *Rubin*, the misrepresentation must relate to the value of the securities involved in the transaction, or otherwise pertain in a direct, material, and easily identifiable way to the securities themselves, as Judge Friendly held, then this Court should say so. We believe this important question of federal jurisdiction should be answered by this Court and not by the Commission.

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2 Quite clearly, the alleged misrepresentation of the guarantor's financial conditon in *Chemical Bank* affected the consideration for the secured loan transaction in that case. *See* 726 F.2d at 945 (Van Graafeiland, J., dissenting).

CONCLUSION

Certiorari should be granted to review the decision and judgment of the United States Court of Appeals for the Second Circuit.

Dated: New York, New York
June 2, 1986

Respectfully submitted,

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